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E.O. 12958: DECL: 10/22/2018
TAGS: [EPET](#) [ENRG](#) [PREL](#) [EINV](#) [ECON](#) [EC](#) [BR](#)
SUBJECT: ODEBRECHT AND PETROBRAS - ECUADOR MOVES AGAINST
BRAZILIAN COMPANIES

REF: A. 07 QUITO 1678
[1](#)B. QUITO 345

Classified By: DCM Andrew Chritton, Reasons 1.4 (b & d)

[1](#)1. (C) Summary: President Correa raised the rhetoric level against two big Brazilian companies, and went further with the construction firm Odebrecht, cancelling its projects in Ecuador and its employees' visas. Correa also pressed Petrobras to quickly renegotiate its contract or face expulsion; on Oct. 18 he announced that Petrobras had agreed to a short-term transitional contract. In response to the Odebrecht expulsion, Brazil cancelled a planned ministerial visit, but in a TV interview Ecuadorian Foreign Minister Salvador attempted to separate the two business-related events from the broader Ecuador-Brazil relationship. Odebrecht's standing in Ecuador has been tainted by allegations of corruption and shoddy construction, while the heavy-handed pressure for Petrobras to renegotiate its contract is comparable to that on other foreign oil companies. End Summary.

Odebrecht Forced to Leave Ecuador

[1](#)2. (C) On September 23, President Correa issued an emergency decree ordering the military to take over the San Francisco hydroelectric plant and four other Odebrecht projects (the Baba and Toachi Pilaton hydroelectric plants, an airport in the town of Tena, and an irrigation system in Manabi province). The order initially stemmed from faulty construction of the San Francisco plant built by Odebrecht for the GOE. The GOE and Odebrecht had been in discussions on repairing the plant and reached an agreement on September 19, but the agreement fell apart. In the following weeks, Odebrecht had reportedly agreed to all of the GOE's demands regarding the plant. However, in early October Correa announced that Odebrecht would have to leave the country, due to "irregularities" in the projects (referring to corruption). Another issue was loans from Brazil's national development bank BNDES to Odebrecht for the construction projects. The GOE has said Odebrecht was responsible for the loans, although the loans have GOE state guarantees.

[1](#)3. (C) On October 9, Correa issued another presidential decree revoking the visas of executives from Odebrecht and its partner in the San Francisco project, the Brazilian state utility company Furnas-Centraes Electricas. The executives were given 48 hours to leave the country. The decree

directed GOE partners in Odebrecht projects to take legal steps to terminate their contracts, and ordered an investigation into the BNDES loan for the San Francisco project. GOE officials have said that the projects will be taken over by local contractors. (Comment: It appears that most of the local contractors do not have the capacity to manage large projects.)

Allegations of Corruption

¶4. (C) Alfredo Vera, head of Ecuador's anti-corruption secretariat, raised questions about the pricing and financing of the Odebrecht contracts. Although we have no insights into the San Francisco project, Post has heard credible allegations of corruption involving Odebrecht's irrigation project in Manabi from a former Minister of Finance who refused to sign the project documents because of his concerns about corruption. Post also heard concerns from a Central Bank official about unfavorable terms in the BNDES loan that supported the irrigation project. Both of these officials approached us separately to report on developments that took place in 2006, the final year of the Palacio Administration.

The Petrobras Situation

¶5. (C) On several occasions in 2007 and 2008, Petrobras has been threatened with "caducity" (cancellation of its contract) for contract irregularities (refs A and B). Petrobras contacts and some petroleum industry contacts have

claimed the threats were intended to put pressure on the company to reach agreement with the GOE on a new oil contract. In early October 2008, the GOE threatened Petrobras with expulsion if the company did not agree to finalize quickly negotiations for a new oil contract.

¶6. (C) On October 17, the GOE and Petrobras quietly reached agreement on a transitory one-year production sharing contract. During this transition period the company must negotiate a services contract. Petrobras contact Patricio Vergara reported that the GOE has agreed to drop the caducity threat. According to Vergara, one of the major obstacles towards reaching a new agreement was that Petrobras strongly resisted the GOE demand that the government receive 70 percent of windfall revenue, since Petrobras's current agreement already has a 50 percent windfall revenue sharing mechanism. Vergara did not provide any details on the final arrangement, but implied that the two sides agreed to split the difference.

Relations with Brazil

¶7. (C) The Correa Administration has tried to distinguish between its relations with Brazil and its actions toward the two companies. Foreign Minister Salvador commented in a television interview October 16 that Ecuador would "advance positively" with Brazil, and noted that the Odebrecht case had been decided and the Petrobras case was being resolved in a manner that would be "absolutely positive" for bilateral relations. In Correa's October 18 radio address, he emphasized that the Odebrecht case was an issue between Ecuador and a private company that did not comply with its contract, not an issue between states. He added that he was sure Brazilian President Lula understood his position. Lula, however, canceled an October 15 visit by the Brazilian Transportation Minister on the subject of the Manta-Manaus transportation link.

Comment

¶8. (C) Two Brazilian firms have undergone unpleasant experiences brought on by Correa's practice of employing intemperate rhetoric (and, in some cases, actions) against

those that have displeased him. However, we believe these statements and actions were brought on by what the companies had done, rather than any sense of underlying problems with Brazil. While we do not have the full story behind Correa's ire with Odebrecht, we suspect that corruption and poor construction by the company may largely explain his actions. In the case of Petrobras, it appears that he was frustrated with Petrobras's refusal to improve the government's share of windfall oil income and he therefore used threats of expelling Petrobras to improve his negotiating position.

¶9. (C) Regardless of the merits of the GOE's claims regarding the Brazilian companies, these were fundamentally contractual disputes, although one may have been colored by malfeasance. Rather than deal with them as such, Correa instead addressed them through dramatic actions and threats, gestures that will continue to undermine investor confidence in Ecuador and that have complicated broader relations with Brazil.

HODGES